SHAREHOLDER OPPRESSION

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INTRODUCTION

1. The most common "vehicle" through which commercial activity is conducted in Australia is through the corporate structure.

2. The focus of this paper will be on the proprietary company and the remedies available to minority shareholders in proprietary companies who might find themselves either in conflict with the majority shareholders or find themselves in circumstances where the majority shareholders act towards the minority shareholders in a way that may be regarded, at law, as oppressive or unfairly prejudicial or unfairly discriminatory pursuant to section 232 of the Corporations Act 2001.

3. In this paper, I will first set out some of the major principles in determining whether conduct by the majority in a company can be regarded as oppressive or unfair. I will then examine some of the common areas in which oppression has most commonly been found by the Courts. They include:

(a) executive shareholders paying themselves excessive remuneration;

(b) majority shareholders restricting dividends without good business reason or for an improper purpose;
(c) reducing a shareholder's interest in the company by making a share issue contrary to the legitimate expectations of the minority and/or contrary to the principle of mutual trust and confidence;

(d) excluding minority shareholders from salaried positions within the company;

(e) board meeting tactics; and

(f) diversion of business from the company by the majority shareholders.

4. I will examine each of the areas referred to above by reference to section 232 of the Corporations Act and by reference to case law setting out the grounds available to the Court to find oppression and examining what limits there are to a finding of oppression.

5. The above areas are only some of the common areas of oppression and should not be regarded as exhaustive. Nor should the cases referred to in this paper be regarded as exhaustive of the areas in which oppression may be found. Each case should be considered in context of its factual matrix.

6. Finally I will briefly examine the remedies available to shareholders who have established oppression. I will refer to some of the orders the Court is able to make pursuant to section 233(1) of the Corporations Act, paying particular attention to the compulsory purchase orders.

7. Throughout this paper I have set out appropriate extracts from cases in order to properly convey the reasoning underlying each principle of law.
THE LAW ON OPPRESSION - SOME GENERAL PRINCIPLES RELATING TO S232 OF THE CORPORATIONS ACT

8. The Court’s power to give relief under section 233 of the Corporations Act depends upon proof that the affairs of the company have been conducted in a manner that is oppressive, unfairly prejudicial to or unfairly discriminatory against a member or members of the company.

9. It is accepted that one no longer looks at the word “oppression” in isolation but rather asks whether objectively in the eye of the commercial bystander, there has been unfairness, namely conduct that is so unfair that reasonable directors who consider the matter would not have thought the decision fair.

10. In Wayde v New South Wales Rugby League Limited (1985) 180 CLR 459 Brennan J said at 472 on the former equivalent to section 232:

The question of unfairness is one of fact and degree which section 320 requires the court to determine, but not without regard to the view which the directors themselves have formed and not without allowing for any special skill, knowledge and acumen possessed by the directors. The operation of section 320 may be attracted to a decision made by directors which is made in good faith for a purpose within the director’s power but which reasonable directors would think to be unfair. The test of unfairness is objective and it is necessary, though difficult, to postulate a standard of reasonable directors possessed of any special skill, knowledge or acumen possessed by the directors. The test assumes (whether it be the fact or not) that reasonable directors weigh the furthering of the corporate object against the disadvantage, disability or burden which their decision will impose, and address their minds to the question whether a proposed decision is unfair. The court must determine whether reasonable directors, possessing any special skill, knowledge or acumen possessed by the directors and having in mind the importance of furthering the corporate object on the one hand
and the disadvantage, disability or burden which their decision will impose on a member on the other, would have decided that it was unfair to make that decision.

11. In Wayde’s case Brennan J concluded that the decision of directors of the New South Wales Rugby Limited to reduce the number of competitors in the Premiership Competition to twelve and to exclude Wests was taken in full knowledge of the disability that the decision would place on Wests. But, it was found, the directors also knew that that the larger competition was burdensome to, and perhaps dangerous for, players and that a shorter season was conducive to better organisation of the Premiership Competition. In determining whether the decision was unfair the Court was bound to have regard to the fact that the decision was made by experienced administrators to further the interests of the game. Brennan J found that there was nothing to suggest unfairness save the inevitable prejudice to and discrimination against Wests, but that was insufficient by itself to show that reasonable directors with the special qualities possessed by experienced administrators would have decided that it was unfair to exercise their power in the way the League’s directors did.

12. Wayde’s case was considered in Re George Raymond Pty Limited; Salter v Gilbertson (2000) 18 ACLC 85 in which Byrne J said (at 91):

The task of the court in determining whether allegations of oppression have been made out is to examine the conduct, not in isolation, but in the context in which it takes place; Re Baggett Well Pastoral Co Pty Limited; Baggett Well Pastoral Company Pty Limited v Reid; Shannon v Reid (1994) 12 ACLC 42; (1993) 12 ACSR 197 at 212 per Debelle J (with whom King CJ and Millhouse J agreed). The mere fact that the conduct has an adverse impact on minority shareholder does not establish oppression. The mere fact that a shareholder has an interest which is a minority interest means that this interest is liable to be
outvoted by the majority and, further, that the shareholder is at risk that a decision made by the majority may have a financial consequence adverse to the minority. This is not, for that reason alone, oppression: *Re M Dalley & Co Pty Limited* (1968) 1 ACLR 489 at 492, per Lush J. Moreover, under the enlarged provision introduced in Australia in 1984, the added matters include the word 'unfairly'. But, as Richardson J pointed out in *Thomas v H.W. Thomas Ltd* the enlarged provision has a wider meaning, picking up conduct that is unjustly detrimental to a minority shareholder. It must, therefore, be shown that the conduct was beyond power or performed otherwise than in good faith or is unfair in accordance with ordinary standards of reasonableness and fair dealing: *Wayde v New South Wales Rugby League Limited* (1985) 3 ACLC 799 at 806; (1985) 180 CLR 459 at 472 per Brennan J.

**SOME COMMON AREAS OF OPPRESSION**

13. The above section of this paper set out some of the general principles concerning oppression as stated by Brennan J in *Wayde's* case. Those general principles should be considered by reference to some areas of shareholder conduct which may be regarded as oppressive.

**Executive Shareholders Paying Themselves Excessive Remuneration**

14. In certain circumstances excessive remuneration paid to a "controller" of a company may amount to oppression under the legislation. As a matter of fact, whether an "excessive" salary or benefits have been paid depends usually on expert evidence of comparable payments for similar responsibilities: see for example *Kizquari Pty Limited v Prestoo Pty Limited* (1993) 10 ACSR 606.
15. Of course, such a comparison is by its nature difficult and imprecise because there can never be a precise match between comparable duties and responsibilities of a particular "controller" or executive shareholders. Rather, in considering whether there has been oppression, the Court should have regard to whether there had been a bona fide attempt by the directors to estimate a proper remuneration.

16. In the *Kizquari's* case a company was incorporated as the trustee of a unit trust, to which the families of the plaintiff and of the other defendants had subscribed. The plaintiff, who had retired from the business, claimed that excessive salaries were being paid to the defendants as employees of the company resulting in a significant reduction in distributions under the Trust. On the question of bona fides of the defendants, the Court said at 611:

The device of managers taking advantage of non-executive shareholders by inflating their remuneration packages is not new, it has been going on for at least a century and a half according to the reported cases. However, even though the court must be astute to see that this device is not used, on the other hand it must be careful not to overly censure directors who make a bona fide attempt to estimate proper remuneration according to the information and expertise that they have available to them. I am quite sure it was much easier for me to work out what a proper remuneration was with the benefit of... (expert evidence)... than it would have been for the directors to do so. In this case the point is not particularly strong because there does not appear to be any bona fide attempt by the directors to actually compute what the proper remuneration was. Their general attitude seems to be that they were entitled to be paid out of the company as much as the business would bear and that it was fair that this should happen because after all they were the people who were working the company up rather than the ... (plaintiffs)... who merely had their capital invested. This of course, was quite the wrong attitude.
17. In Kizquari's case there did not appear to have been a "bona fide" attempt by the directors to estimate a proper remuneration and the Court ordered that the overpayments as found on the basis of evidence before the Court should be paid back into the assets of the trust by the defendant families.

**Majority Shareholders Restricting Dividends Without Good Business Reason**

18. A mere failure to pay dividends, even where they are able to be paid, does not of itself constitute oppression or unfairness. It may, however, amount to oppression in some circumstances. It is necessary to consider the history of the company, the extent of its financial needs, and the reasonable expectation of its members: see, for example, *D G Brims & Sons Pty Limited* (1995) 16 ACSR 559.

19. The *Brims* case involved a closely held company which was a successful manufacturer of timber products. All but two of the thirty shareholders of the company were the descendants of Donald G Brims, the founder of the business. The applicants in the *Brims case* were the granddaughter of the founder and her family which held 31.12% of the ordinary issued shares in the company. The applicants alleged oppressive or unfair conduct towards them, and sought orders for the purchase of their shares.

20. The major grounds for claiming oppression included that there was no dividend issued in 1991, that the applicants were excluded from board representations, that the company was paying the costs of the respondents in defending the proceedings and that the price fixed by the Board and the company's auditor for the applicant's shares was unreasonably low.
21. On the question whether the failure to pay a dividend in 1991 was oppressive, the Court considered the application in the light of such things as the history of the company, its opposition to borrowing, the extent of its needs, the prevailing and expected financial circumstances, the reasonable expectations of members generally, and the absence of any particular need of the applicants. On the basis of those factors the Court determined that the AGM’s decision not to pay a dividend was justified. The factual matters that were taken into account by the Court in reaching its decision included:

(a) the company had an old policy of saving rather than borrowing and had followed a business philosophy of “paying its own way”;

(b) each year the Board would discuss the payment of dividends in the light of required additional capital items and recurrent expenses;

(c) the directors report for the year ended 30 June 1989 spoke of difficult times in which sales had been a major problem: capital expenditure in the 1991 financial year was more than $930,000 which far exceeded the net profit after tax of less than $550,000.

(d) the directors report identified an urgent need to finance upcoming major capital items and the Court found the recommendation of the Board not to pay a dividend in 1991 was not prompted by any improper motive or extraneous object;

(e) only the applicants were in favour of the dividend. By the time that a dividend issue was considered, however, the applicant’s interests were no longer “co-extensive with those of the other shareholders”.
The applicants were not concerned with the company’s future, they wanted to be bought out. Notwithstanding available funds, all the other shareholders accepted that the company’s interests would best be served by not declaring a dividend and to use company funds for the replacement of plant and equipment. In the circumstances, the shareholders could reasonably have regarded that the financial position of the company would justify not making a dividend payment for 1990/1991.

22. In contrast it may be oppressive not to declare a dividend if the board of directors do not review its policy of not declaring a dividend in changing economic circumstances and in circumstances in which the directors have reviewed their salary for the same period leading to a significant increase in salary: Shamsallah Holdings Pty Limited v CBD Refrigeration and Airconditioning Services Pty Limited (2001) 19 ACLC 517.

Reducing Shareholders’ Interest in the Company by Making a Share Issue Contrary to Legitimate Expectations and/or Contrary to Mutual Trust and Confidence

23. Generally there is no oppression in a company allotting further shares in the company. There can be oppression, however, if the majority shareholders’ intention in making an allotment of shares is to further their self interest and/or it offends the principle of mutual trust and confidence.
Self Interest

24. In *J D Hannes v M J H Pty Limited & Ors* 7 ACSR 8, the Court of Appeal considered the question of oppression in the context of a further allotment of shares. In that case the first appellant (the defendant in the Court below) was the governing director and held all the “governor’s” shares in the company which conferred on him wide powers including the right to “the whole management, government and control of the company”. The appellant also had voter control at shareholders meetings.

25. At a meeting of directors, shares of the company were allotted to another company, Jamar Pty Limited, a company of which the appellant and his second wife were the shareholders. At a later time, the appellant and the company executed a service agreement which provided for the appellant to be paid a large salary package.

26. The other shareholders in the company, the respondents on the appeal (the plaintiff in the Court below), contended that the share allotment and the service agreement constituted breaches by the appellant of his fiduciary duty to the company and that such conduct entitled the Court to make orders under the former equivalent to section 232 of the *Corporations Act*.

27. As a factual matter the trial judge concluded that the motivation for the appellant in causing the company to allot the shares and to enter into the service agreement was his desire to obtain a financial benefit for himself and second wife.
28. In the present case the Court of Appeal found that the substantial object of the governing director was one of self interest. Once that is acknowledged, the Court said, there was no legitimate basis left for the governing director’s actions even if they were intra vires. The Court of Appeal upheld the primary judge’s orders that both the allotment of shares and the employment agreement be set aside.

*Legitimate Expectation and Mutual Trust and Confidence*

29. Underlying the concept of oppression is the concept of legitimate expectations and mutual trust and confidence. This is exemplified in *Re Dalkeith Investments Pty Limited* 9 ACLR 247. That case involved a small proprietary company, the shareholders of which included a married couple Mr and Mrs S and their daughter and son-in-law. Mr and Mrs S were divorced after the establishment of the company and thereafter considerable bitterness and animosity prevailed between Mr S on one side and Mrs S and her daughter and son-in-law on the other.

30. At a meeting after the dissolution of marriage between Mr and Mrs S, Mrs S, her daughter and son-in-law passed a resolution that 1500 ordinary shares of $2 par value be issued to existing shareholders proportionate to their existing shareholding. The Court found that the steps taken by Mrs S’s daughter and son-in-law with the acquiescence of Mrs Smith in passing the resolution were undertaken not in the interests of the company as a whole but for the collateral purpose of gaining control and of diluting Mr S’s “equity” in the company. The Court found that Mrs S, her daughter and son-in-law knew when they passed the resolution that Mr S was unlikely at his age, and in the context of family law proceedings involving the financial interests of the marriage, would want to make a further investment in the
company. The Court in those circumstances ordered that Mrs S, her daughter and son in law purchase the shares held by Mr S. In making that order the Court stated, at 252:

The case is therefore one in which, as I find, the parties, when they acquired their shares in the company, entered into an arrangement, which was no doubt implied rather than expressed, the substance of which was that they constitute a partnership in corporate form. That arrangement was a family arrangement in which their expectation was that they would act in the affairs of the company in the spirit of friendly cooperation for their common benefit and not in which they contemplated that their rights and relations inter se would be governed by a strict application of the rules of company law. It is no part of my function to attempt to analyse or apportion the reasons for theanimosity that has grown up between the parties. The divorce, and the inevitable litigation that has preceded or accompanied it, has in my view, destroyed the relationship of mutual trust and confidence which might otherwise have been expected to subsist between them as members of the same family group. It is no longer possible for them to work together for the common good or to rely, for the protection of their interests and investments in the company, upon the goodwill which they supposed would exist between them. The point has now been reached where such a state of animosity exists between them as precludes all reasonable hope of reconciliation and friendly cooperation in the affairs of the company.

Excluding Minority Shareholders from a Salaried Position Within the Company

31. The principle of legitimate expectation referred to in the Dalkeith case applies equally in circumstances in which a minority shareholder is removed from a salaried position within the company. That removal may be unfair even though it might be a valid exercise of the powers of the majority of the directors if there was an expectation of the continuing
participation and the sharing equally of the day to day conduct of the business as well as the management of it at the level of directors. See for example, *Hogg v Dymock & Ors* 11 ACSR 14.

32. In *Re Westbourne Galleries Limited* [1973] AC 360 Lord Wilberforce stated at page 379 that it would not be possible to define the circumstances in which the legitimate expectation principle would apply. The fact that a company is a small one or a private company is not enough. Lord Wilberforce observed that very many of the small or private companies were associations based purely on commercial relationships of which the basis of that association is adequately laid down in the company's constitution. He stated that the "superimposition of equitable considerations" required something more than the existence of a small private company and that typically may include one or more of the following:

(a) an association formed or continued on the basis of a personal relationship, involving mutual confidence;

(b) an agreement, or understanding, that all, or some of the shareholders shall participate in the conduct of the business;

(c) restriction upon the transfer of the members' interest in the company – so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

33. In *Hogg's* case Mrs H and Mr and Mrs D operated a tourist venture through a proprietary company. There were three Directors Mrs H and Mr and Mrs D. Mrs H held one share and Mr and Mrs held one share jointly. Mrs H was
employed by the company. Due to tensions between Mrs H and Mr and Mrs D, Mr and Mrs D purported to appoint themselves as managing directors and dismissed Mrs H. Mrs H brought proceedings for breach of contract and oppression under the equivalent of section 232 of the Corporations Act and sought an interlocutory injunction. The Court found that there was a serious question to be tried for unfairness relating to Mrs H’s dismissal and under the equivalent of section 232. The Court however, refused to grant an interlocutory injunction because damages were an adequate remedy.

34. It is important to note that in Hogg’s case, although the Court recognised the principle of legitimate expectation and the concept of mutual trust and confidence, the Court also recognised that the board in certain circumstances could properly decide to terminate the employment of an equal shareholder where this was in the best interests of the company. A business judgment, which is judged to be objectively reasonable and untainted by improper motives, can be described as one which will be respected by the Courts.

Board Meeting Tactics

35. In certain circumstances the cumulative effect of a series of incidents relating to board meetings can amount to oppression, even if the matters in isolation might be regarded as trivial: see John J Starr (Real Estate) Pty Limited v Robert R Andrew & Ors 6 ACSR 63.

36. In Starr’s case the company conducted a business as a franchisor of real estate agencies. A minority shareholder in the company sought orders for winding up of the company on the grounds of oppression under the equivalent to s232 of the Corporations Act or under the “just and equitable
grounds" of the Corporations Act. The applicant held 22% of the issued capital in the company. The other two shareholders and the defendants in the matter, Mr R and his wife, held 63% of the issued capital in the company. Mr R also had an entitlement to nominate two directors to the board.

37. The applicant alleged that the affairs of the company were being conducted oppressively and listed a number of alleged instances of oppressive conduct which numbered 16 in total. The major allegations included that Mr R ran the company in an overbearing manner, referring to the company as "my company" and to the board as "my board" and behaved as though that was the fact.

38. Mr A had "moral ascendancy". The other shareholders were for the most part people who were much younger than Mr A and who had come up through the organisation. Mr R regarded minority shareholders as a nuisance and an unwelcome interference with the running of the company.

39. The applicant complained of Mr R's control of board meetings, which included bringing forward matters without sufficient notice; refusing to provide the board with a budget; that board meetings were conducted without regard to the views of directors; and that there was a practice of mini-meetings.

40. The Court in Starr's case set out a number of general principles relating to oppression and the conduct of board meetings. Some of those principles included:
(a) it is oppressive for a member of a board of directors using his or her tactical skills to secure an advantage, at least beyond a certain limit; this is so whether the director concerned is in the majority or in the minority.

(b) when choosing a representative director a majority shareholder is not under any obligation to choose the most suitable person for the position; a majority shareholder may appoint his friend or a person whom he might reasonably expect will usually vote in a certain way;

(c) if a person, relying on majority control, dispenses with the proper procedure in order to obtain a result relying merely on his voting power may be oppressive if it deprives the minority shareholders of their right as members of the company to have its affairs conducted in accordance with the company’s constitution;

(d) the mere subordination of the wishes of the minority by the exercise of a voting power of the majority is not of itself oppressive provided that voting power is not used to deprive the minority to have the affairs of the company conducted in accordance with the company’s constitution;

(e) it is not oppressive for majority shareholders to adopt a company business policy on which there are legitimate differences of opinion;

(f) oppression is something done against a person’s will; it must result from some “overbearing act or attitude on the part of the oppressor” ;
in order to establish oppression, the minority must establish at least unfairness; it is not enough to merely assert that the minority have lost "confidence" in the management of the company or that the minority are always "outvoted" on a question of company management and/or policy;

courts must be slow to interfere with the responsibility of management of a company; it is not enough that decisions of the majority adversely affect the minority; it must be shown that there is a lack of good faith or that no reasonable board could have come to the decision reached.

**Diverting Business from the Company by the Majority Shareholders**

41. Diversion of business from the company by the majority shareholders can amount to oppression: see for example *Scottish Cooperative Wholesale Society Limited v Meyer* [1959] AC 324.

42. The *Scottish* case involved a situation in 1950s England in which the manufacture of rayon cloth was controlled and remained controlled until 1952. The Scottish Cooperative in 1946 formed a subsidiary company with two individuals who had a licence to manufacture rayon cloth. The subsidiary company was to enable the Scottish Society to participate in the manufacture and sale of rayon materials which it otherwise would not have been able. Shares in the subsidiary company were issued as follows: the Scottish Society acquired 4,000 shares and the two individuals who held the relevant licences for the manufacture of rayon cloth in the amount of 3,900. The subsidiary company traded successfully for several years and earned substantial profits. In 1951 the Society sought to purchase from the
individuals their shares at less than their true value. The offer was rejected by the individuals. After the removal of government control the Scottish Society adopted a policy of transferring the company’s business to a new department within its own organisation, thereby forcing down the value of the company’s shares.

43. The Court found that the actions of the Scottish Society was oppressive and the two individuals were entitled to relief by way of compulsory purchase of the shares by the Scottish Society. In reaching this decision, the Court per Lord Keith of Avonholm said at 361 the following:

My Lords, if the Society could be regarded as an organisation independent of the company and in competition with it, no legal objection could be taken to the actions and policy of the Society. Lord Carmont pointed this out in the Court of Sessions. But that is not the position. In law, the Society and the company were, it is true, separate legal entities. But they were in the relation of partner and subsidiary companies... The company was in substance, though not in law, a partnership consisting of the Society and the respondents. Whatever may be the other different legal consequences following on one or the other of these forms of combination, one result, in my opinion, followed in the present case from the method adopted, which is common to partnership, that there should be the utmost good faith between the constituent members......

In these circumstances, I have no doubt that the conduct of the Society was oppressive.
LEGISLATIVE REMEDIES

44. Section 233 of the Corporations Act provides that in the event that a Court finds that there has been oppression pursuant to section 232 the Court is able to make any order that it considers appropriate.

45. Which order is appropriate will depend upon the circumstances of each case, but the order sought, other than interlocutory orders, should be those orders which dispose of the matter finally and which a Court would normally make having regard to the circumstances. The most common form of remedy sought by minority shareholders is the purchase of shares or that the company be wound up. With regard to these remedies the following should be considered:

(a) ordinarily the Court is reluctant to order the winding up of a successful solvent company: Cumberland Holdings Ltd v Washington H. Soul Pattinson and Co Ltd (1977) 2 ACLR 307; winding up is a drastic remedy. It carries with it the possibility that assets will be realised at a lower value than if the company is sold as a going concern;

(b) when valuing the shares of the oppressed shareholder for the purposes of making an order under section 233 of the Corporations Act, the Court should endeavour to place the oppressed shareholder in a position as if the oppression had not occurred. In this regard the Court in ES Gordon Pty Limited v Idameneo (1994) 15 ACSR 536 at 540 said the following:
... in cases dealing with the price at which an oppressor is to purchase the oppressed shares in a company the word “fair” has been given significance. For instance, in *Scottish Cooperative Wholesale Society Limited v Meyer* [1959] AC 324 at 369, Lord Denning said that one of the most useful orders that could be made is to ‘order the oppressor to buy their shares at a fair price: a fair price would be, I think the value which the shares would have had at the date of the petition, if there had been no oppression’. The concept of ‘fair price’ in this sense has been followed subsequently.....The flavour of the judgments in the company oppression cases is that looking to the fair value one must look at all the circumstances of the case and seek to put the oppressed in the same position as nearly as can be as if there had been no oppression, erring, if there is to be any erring, on the side of the oppressed.;

(c) as a general proposition it is inappropriate to discount the value of the shares held by the oppressed party. In this regard the Court in *Roberts v Walter Developments Pty Limited* (1997) 15 ACLC at 906 stated that:

Generally, it appears that where a court orders the purchase of a share by way of relief against oppression, it is considered to be inappropriate to apply any discount to a minority share which might be applied if one was seeking a ‘market value’ of the share. The reason is, that the transaction is not a market one but is a judicial remedy. It further appears to be generally considered that it is unfair to apply discount to a sale which takes place only because of oppressive conduct on the part of others.

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